

## Board committees



The Act provides the board with the power to appoint board committees, and to delegate to such committees any of the authority of the board. The authority of the board to appoint board committees is subject to the company's Memorandum of Incorporation.

If the company's Memorandum of Incorporation, or a board resolution establishing a committee, does not provide otherwise, the committee may include persons who are not directors of the company. However, it should be noted that where non-directors are appointed to a board committee, such persons are not allowed to vote on a matter to be decided by the committee).

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**Board committees constitute an important element of the governance process and should be established with clearly agreed reporting procedures and a written scope of authority. The Act recognises the right of a board to establish board committees but by doing so, the board is not exonerated of complying with its legal responsibilities.**

- King III principle 2.23 par 125

King III recommends that the delegation of powers to a committee be made official, in order for the members to have formal terms of reference to determine the scope of their powers, and the responsibilities they bear. The terms of reference should include detail pertaining to:

- the composition of the committee
- the objectives, purpose and activities
- the powers that have been delegated
- any mandate to make recommendations to the board
- the lifespan of the committee, and
- how the committee reports to the board.

The Act requires public companies and state owned companies to appoint an audit committee comprising three independent non-executive directors. King III proposes that all other companies provide for the appointment of an audit committee (the composition, purpose and duties to be set out in the company's Memorandum of Incorporation). In addition, King III proposes that the board should appoint the audit, risk, remuneration and nomination committees as standing committees. The board may also consider establishing governance, IT steering and sustain-ability committees.

Smaller companies need not establish formal committees to perform these functions, but should ensure that these functions are appropriately addressed by the board.

The Act requires listed public companies and state owned companies, as well as any other company that scored more than 500 Public Interest Score points in any two of the last five years, to establish a social and ethics committee. This committee should comprise at least three members. The members may be directors or prescribed officers, but at least one must be a director that is not involved in the day-to-day management of the company, i.e a non-executive director.

Board committees are allowed to consult with or receive advice from any person, including employees, advisors, or other board committees.

King III suggests that all board committees, other than the risk committee, should only comprise members of the board and should have a majority of non-executive directors. The majority of the non-executive directors serving on these committees should be independent. Committees should be chaired by independent non-executive directors, other than the executive committee which is ordinarily chaired by the CEO.

Advisors, experts and other external parties may attend committee meetings by invitation. Non-directors serving as members on committees of the board are not entitled to vote, and will be subject to the same standards of conduct and liability as if they were directors. Executive directors and senior management may be invited to attend committee meetings if the chair of the committee considers their input and contribution to be of value to the decision-making process.

The composition and functions of each of these sub committees are discussed below.

### **The Nomination Committee**

The role of the nomination committee is to review, on a regular basis, the composition of the full board, and where it appears that the board is lacking in skills or experience in a certain area, to identify how best to rectify the situation. This may involve identifying skills that are required, and those individuals best suited to bring these to the board.

King III suggests that the committee should only comprise members of the board. The majority of the members should be non-executive, of which the majority should be independent. The ideal situation is for the chairperson of the board to also chair the nomination committee, failing which an independent non-executive director should be the chairperson.

The committee is empowered to consider the size and balance of the full board, and to make recommendations where, in the opinion of its members, improvements could be made. It remains the responsibility of the full board of directors to consider the recommendations made and to vote on any nominated appointments or, as the case may be, suggested removals.

One of the important considerations for the committee is whether there are adequate succession plans in place to mitigate the effects of losing key members of the board, specifically non-executives as these individuals may be more difficult to replace than executive directors who have followed a defined career path through the management of the company.

The role of the nominations committee may be extended to also consider the skill, experience and succession planning with respect to the executive management team.

### **The Remuneration Committee**

The remuneration of a company's directors is one of the most sensitive and topical issues facing the board of directors today. It is therefore considered a crucial element of good corporate governance to establish a committee whose sole focus it is to consider and recommend the level and form of the directors' (and senior management's) remuneration.

King III suggests that the committee should only comprise members of the board. The majority of the members should be non-executive, of which the majority should be independent.

The chairman of the committee should be an independent, non-executive director. The chair of the board should not chair the remuneration committee, but may be a member.

One of the most important responsibilities of the members of the committee is to remain up to date on appropriate levels, structuring methods and types of remuneration in the environment in which the company operates.

The members of the committee are required to maintain a fine balance between recommending over-generous remuneration which is not in the interests of the shareholders, and a level of remuneration which fails to attract the desired quality of individual to the board.

While it is usually within the committee's mandate to deliberate on the remuneration of the non-executive directors, it is up to the shareholders to make the final decision on the appropriate level.

### The Risk Committee

Risk management is an often misunderstood discipline within a company. Too often the responsibility for ensuring that the significant risks are adequately managed is not acknowledged, or is inappropriately delegated to the audit committee. There are two reasons why the risk management function should not report to the audit committee, but should be monitored by a separate risk committee.

The first is that, as a consequence of the composition of the committee, the function will often have financial focus when risk management should correctly extend far beyond the finances of a company.

Secondly, the audit committee should act as an independent oversight body.

Having to directly oversee the risk management function would generally involve a large amount of detailed review of the processes and workings of the company.

This would necessarily have a detrimental effect on the objectivity of the audit committee's members when considering reports of the risk management function. The formation of a separate committee recognises the fact that the identification and management of risks impacting the business, and the disclosure of these to the shareholders is vital to good governance.

King III recommends that the committee should have at least three members, and may comprise executive and non-executive directors, and even non-directors.

The chairperson of the committee should be a non-executive director. The chairperson of the board should not chair this committee, but may be a member.

The role of the committee is to perform an oversight function. In doing so, it should consider the risk policy and plan, determine the company's risk appetite and risk tolerance, ensure that risk assessments are performed regularly, monitor the whole risk management process, and receive assurance from internal and external assurance providers regarding the effectiveness of the risk management process. In turn, management is responsible for the design, implementation and

effectiveness of risk management, as well as continual risk monitoring.

It is of vital importance that members of the risk committee have experience within the industry. This would allow them to identify areas of risk and be aware of the appropriate methods of managing the company's exposure via internal (the control environment) or external (such as thorough insurance cover) means.

To operate effectively, it is recommended that the committee produces reports that are reviewed and signed by the full board as acknowledgment that their responsibilities in this regard have been adequately discharged.

### The Audit Committee

King III emphasizes the vital role of an audit committee in ensuring the integrity of financial controls and integrated reporting (both financial and sustainability reporting), and identifying and managing financial risk. This sentiment is confirmed in the Act. The appointment of an audit committee is regulated as part of the enhanced accountability and transparency requirements set out in Chapter 3 of the Act. The Act requires all public companies and all state owned companies to appoint an audit committee. Any other type of company may elect to appoint an audit committee (although the provisions of the Act pertaining to the audit committee will only apply to these companies to the extent provided for in their respective Memorandums of Incorporation.

Notwithstanding the requirements of the Act, King III proposes that all companies should have an audit committee.

The Act determines that where the appointment of an audit committee is required, the audit committee must be appointed by the shareholders at every annual general meeting.

This requirement highlights the importance of the board's nomination committee. As all audit committee members must be directors (members of the board), it is important that the nominations committee identifies suitably skilled and qualified individuals to nominate for appointment to the audit committee. The shareholders may appoint anyone they deem fit and proper.

Section 94 of the Act determines that the audit committee must consist of at least three members. Each member of the committee must be a director of the company and not:

- be involved in the day to day management of the company for the past financial year;
- be a prescribed officer or full-time employee of the company for the past 3 financial years;
- be a material supplier or customer of the company such that a reasonable and informed third party would conclude in the circumstances that the integrity, impartiality or objectivity of that director is compromised by that relationship; and
- be related to anybody who falls within the above criteria.

The requirements of section 94 are prescriptive. It appears that if the company appoints an audit committee with persons other than those prescribed, it would not be an audit committee as required by the Act. As a result, any functions undertaken by a non-compliant (that is an "incorrectly constituted") audit committee will not have been performed by the audit committee as required by the Act.

The audit committee can consist of as many members as the company wishes to appoint, but each of them must meet the criteria and each of them must be a director of the company. The audit committee would, of course, be entitled to utilise advisors and obtain assistance from other persons inside and outside of the company. The audit committee may also invite knowledgeable persons to attend its meetings. However, the formally appointed members of the audit committee entitled to vote and fulfil the functions of the audit committee will have to meet the criteria (non-executive independent directors) in accordance with the prescribed requirements.

In this regard, cognisance should be taken of the position of shareholders as potential members of the audit committee. The Act makes no reference to shareholders, and the value judgement pertaining to independence relates only to suppliers and customers. The mere fact that a person holds shares in the company (or meets any of the other factual tests such as being related to a supplier) would not, on its own, preclude such a person from serving on the audit committee. It is proposed that, in line with the best practice principles set out in King III, the appointment of shareholders to the audit committee be carefully considered. A judgment on

the effect of the shareholding or other relationship is required in order to establish the likely factual impact on the independence of a particular person.

The statutory duties of the audit committee include:

- making submissions to the board regarding the company's accounting policies, financial controls, records and reporting
- nominating an auditor that the audit committee regards as independent
- determining the audit fee
- ensuring that the appointment of the auditor complies with the Companies Act and other relevant legislation
- determining the nature and extent of non-audit services
- pre-approving any proposed agreement with the auditor for the provision of non-audit services
- preparing a report to be included in the annual financial statements describing how the committee carried out its functions, stating whether the auditor was independent, and commenting on the financial statements, accounting practices and internal financial control measures of the company
- receiving and dealing with relevant complaints, and
- any other function designated by the board.

Since the Act prescribes the appointment process, composition and functions of the audit committee, it can now be described as a statutory committee. The audit committee will bear sole responsibility for its decisions pertaining to the appointment, fees and terms of engagement of the auditor. On all other matters it remains accountable to the board and, as such, it will function as a board committee.

An interesting development is the fact that the audit committee is now obliged to also report to shareholders. The audit committee will report to shareholders by including in the annual financial statements the audit committee's report describing how the committee carried out its functions, stating whether the auditor was independent, and commenting on the financial statements, accounting practices and internal financial control measures of the company.

In addition to the legislative duties set out in the Act, King III proposes a number of additional functions, including:

- overseeing
- financial risks and reporting
- internal financial controls
- fraud and IT risks as they relate to financial reporting
- ensuring that a combined assurance model is applied to provide a coordinated approach to all assurance activities (in terms of this model, assurance should be done on three levels, i.e. management, internal assurance providers and external assurance providers)
- overseeing integrated reporting (both financial and sustainability reporting)
- satisfying itself with regard to the expertise, resources and experience of the finance function
- overseeing the internal audit function
- playing a key role in the risk management process, and
- overseeing the external audit process.

In terms of King III, the audit committee is responsible to ensure integrated reporting (integrating financial and sustainability reporting).

As a minimum, the audit committee should provide the following information in the integrated report:

- a summary of the role of the audit committee
- a statement on whether or not the audit committee has adopted a formal terms of reference that has been approved by the board and if so, whether the committee satisfied its responsibilities for the year in compliance with its terms of reference
- the names and qualifications of all members of the audit committee during the period under review, and the period for which they served on the committee
- the number of audit committee meetings held during the period under review and members' attendance at these meetings
- a statement on whether or not the audit committee considered and recommended the internal audit charter for approval by the board
- a description of the working relationship with the chief audit executive
- information about any other responsibilities assigned to the audit committee by the board
- a statement on whether the audit committee complied with its legal, regulatory or other responsibilities, and

- a statement on whether or not the audit committee recommended the integrated report to the board for approval.

Ethical leadership and social responsibility is highlighted in King III. These same sentiments are echoed in the Act. Although it may be argued that the provisions of the Act are onerous and prescriptive, it should be acknowledged that the intention is for the audit committee to play a key role in ensuring accountability and transparency. As an independent, objective body, it should function as the company's independent watchdog to ensure the integrity of financial controls, combined assurance, effective financial risk management, and meaningful integrated reporting to shareholders and stakeholders alike.

#### **Social and Ethics Committee**

During the public hearings on the Companies Bill conducted by the Portfolio Committee on Trade and Industry in 2007, a proposal was made to include a requirement in the new Act to oblige certain companies to appoint a member of a trade union as a board member (director). The Portfolio Committee rejected this proposal, but presented a compromise. It was argued that there is a definite need in the South African context to encourage large companies (especially those companies that have a significant impact on the public interest) to not only act responsibly, but also to be seen doing so and to account from the public interest perspective for their decision making processes and the results thereof. In essence, it was argued that these companies should be obliged to develop a social conscience, and behave like responsible corporate citizens.

As such, the Companies Act now provides the Minister of Trade and Industry with the authority to require certain companies to have a social and ethics committee, having regard to the impact such companies have on the public interest. However, regardless of the requirement to appoint a social and ethics committee, the directors and prescribed officers of all companies are bound to act in accordance with an acceptable standard of conduct.

In terms of this standard, directors and prescribed officers are obliged to act in the best interest of the company. In this regard, the Act subscribes to the “enlightened shareholder value approach” – which requires that directors are obliged to promote the success of the company in the collective best interest of shareholders, which includes, as appropriate, the company’s need to take account of the legitimate interests of other stakeholders including among others, the community, employees, customers and suppliers. In terms of section 72 of the Companies Act (read with Companies Regulation 43), the following companies should have appointed a social and ethics committee within one year after the Act became effective (i.e. by 30 April 2012):

- every state owned company
- every listed public company and
- any other company that has, in any two of the previous five years, had a public interest score of at least 500 points.

The social and ethics committee must comprise not less than three members. These members may be directors or prescribed officers of the company, however, at least one must be a director who is not involved in the day-to-day management of the company’s business, i.e. a non-executive director, and must not have been so involved during the previous three financial years.

In terms of Companies Regulation 43 a social and ethics committee has to monitor the company’s activities with regard to matters relating to:

- social and economic development, including the company’s standing in terms of the goals and purposes of:
  - the 10 principles set out in the United Nations Global Company Principles;
  - the Organisation for Economic Co-operation and Development (OECD) recommendations regarding corruption (refer to the OECD website for further details ([www.oecd.org](http://www.oecd.org)));
  - the Employment Equity Act, No 55 of 1998;
  - the Broad-Based Black Economic Empowerment Act, No 53 of 2003;
- good corporate citizenship, including the company’s:
  - promotion of equality, prevention of unfair discrimination, and measures to address corruption;
  - contribution to development of the communities in which its activities are predominantly conducted or within which its products or services are predominantly marketed; and
  - record of sponsorship, donations and charitable giving;
- the environment, health and public safety, including the impact of the company’s activities and of its products or services;
- consumer relationships, including the company’s policies and record relating to advertising, public relations and compliance with consumer protection laws; and
- labour and employment matters.

If one considers the requirements of King III with respect to ethical leadership and ethical behaviour, it appears advisable to assign to the social and ethics committee some of the responsibilities in this regard.

The additional functions may include:

- reviewing the adequacy and effectiveness of the company's engagement and interaction with its stakeholders,
- considering substantive national and international regulatory developments, overseeing their operationalisation as well as practice in the fields of social and ethics management,
- reviewing and approving the policy and strategy pertaining to the company's programme of corporate social investment,
- determining clearly articulated ethical standards (code of ethics), and ensuring that the company takes measures to achieve adherence to these in all aspects of the business, thus facilitating a sustainable ethical corporate culture within the company,
- monitoring that management develop and implement programmes, guidelines and practices congruent with the company's social and ethics policies,
- reviewing the material risks and liabilities relating to the provisions of the code of ethics, and ensuring that such risks are managed as part of the company's risk management programme,
- reviewing the company's performance in implementing the provisions of the code of ethics and the assertions made in this regard,
- obtaining independent external assurance of the company's ethics performance on an annual basis, and include in the Integrated Report an assurance statement related to the ethics performance of the company, and
- ensuring that management has allocated adequate resources to comply with social and ethics policies, codes of best practice and regulatory requirements.

The social and ethics committee must report to shareholders at the Annual General Meeting. At least one member of the committee must attend the Annual General Meeting of the company to report back to shareholders on the activities of the company. Although there is no legislative requirement for the committee to issue a written report, it is recommended that a written report be included in the company's Integrated Report, Director's Report or its Governance report, whichever is the most appropriate in the circumstances.

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